

Message Text

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TAGS: ECON, OECD

SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF TURKEY, JULY 12, 1976

REFS: (A) EDR(76)16, (B) ANKARA 5158

1. SUMMARY: AT EDRC REVIEW TURKISH DEL (LED BY OZOL OF PERMANENT DELEGATION) CONCENTRATED ON CONVINCING SECRETARIAT AND EDRC TT EVOLUTION OF TURKISH ECONOMY WAS PROCEEDING AS PLANNED. TURKS SAID THAT GAPING 1975 CURRENT ACCOUNT DEFICIT WAS INTENTIONAL BY-PRODUCT OF GOVERNMENT POLICIES TO MAINTAIN GNP GROWTH DURING OECD-AREA RECESSION. THEY EXPECT WIDENING OF DEFICIT IN 1976, AND INSISTED THAT ITS FINANCING WOULD NOT BE DIFFICULT. SECRETARIAT AND SEVERAL EDRC DELS (INCLUDING U.S.) NOTED LACK OF EVIDENCE SUPPORTING TURKISH OPTIMISM. IN CONTRAST TO CONCLUSIONS OF SECRETARIAT ANALYSIS, TURKS DENIED THAT DEMAND MANAGEMENT POLICIES HAD HIGHLY INFLATIONARY IMPACT IN 1975. SIMILARLY, WHILE THEY

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EXPECT INCREASE IN BUDGETARY DEFICIT IN 1976, SAID THAT

DEFICIT WOULD BE FINANCED WITHOUT RESORT TO INFLATIONARY DEBT MONETIZATION. TURKS REJECTED SECRETARIAT RECOMMENDATION THAT PATTERN OF GROWTH SHOULD BE ORIENTED TOWARD JOB CREATION. THEY STRESSED THAT CAPITAL-INTENSIVE GROWTH NECESSARY TO INCREASE LABOR PRODUCTIVITY AND THUS TO ENHANCE COMPETITIVENESS INTERNATIONALLY. EDRC NOT SOLD BY TURKISH ARGUMENTS AND CONCLUDED THAT: (A) WHILE POSSIBLY NOT SHORT-TERM PROBLEM, FINANCING OF CURRENT ACCOUNT DEFICIT WOULD BECOME INCREASINGLY DIFFICULT IN MEDIUM TERM UNLESS CURRENT ACCOUNT DEFICIT REDUCED; (B) REDUCTION OF BUDGETARY DEFICIT AND AVOIDANCE OF DEBT MONETIZATION CRUCIAL TO INTERNAL AND EXTERNAL STABILITY; (C) TURKS SHOULD PLACE MORE EMPHASIS ON INTERNATIONAL COOPERATION SINCE BENEFITS DERIVED THEREFROM (DIRECT INVESTMENT, TOURISM, ETC.) COULD CONTRIBUTE MATERIALLY TO THEIR DEVELOPMENT OBJECTIVES. END SUMMARY.

2. SHORT-TERM PROSPECTS; CURRENT ACCOUNT: TURKS ARGUED THAT DRAMATIC INCREASE IN 1975 CURRENT ACCOUNT DEFICIT WAS INTENTIONAL, AN EXPECTED BY-PRODUCT OF THEIR POLICY EFFORTS TO MAINTAIN HIGH GROWTH RATE (8.1 PERCENT IN 1975) IN FACE OF OECD-AREA RECESSION. MOREOVER, THEY FORECAST WIDENING OF DEFICIT TO \$2 BILLION IN 1976. TURKS WERE OPTIMISTIC THAT CURRENT ACCOUNT COULD BE FINANCED WITHOUT DIFFICULTY THROUGH SHORT-TERM CAPITAL INFLOWS (PRIMARILY DEPOSITS INTO CONVERTIBLE TURKISH LIRA ACCOUNTS). SECRETARIAT POINTED TO VOLATILITY OF SHORT-TERM CAPITAL FLOWS AND UNDERLINED DANGERS OF EXCESSIVE RELIANCE ON SHORT-TERM BORROWING. TURKS REMARKED THAT DEPOSITS INTO CONVERTIBLE LIRA ACCOUNTS HAD CONSISTENTLY EXCEEDED WITHDRAWALS IN 1975 AND THAT THERE WAS NO REASON TO EXPECT TREND TO CHANGE THIS YEAR. UNDAUNTED, SECRETARIAT NOTED THAT TERMS ON WHICH DEPOSITS RENEWED COULD BECOME ONEROUS IF INTERNATIONAL CAPITAL MARKETS TIGHTENED AS DEMAND FOR FUNDS INCREASED WITH OECD RECOVERY. TURKS DISCOUNTED THIS POSSIBILITY. U.S. COMMENTED THAT TURKISH RESERVES HAD FALLEN BY \$1 BILLION OVER TWO YEARS ENDING DEC 1975 AND HAD DECLINED BY ANOTHER \$200 MILLION IN FIRST FIVE MONTHS OF 1976. U.S. DREW CONCLUSION THAT FINANCING MIGHT NOT BE AS LIMITED OFFICIAL USE

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ABUNDANT AS TURKS EXPECTED. EDRC CONCLUDED THAT TURKS NOT LIKELY TO ENCOUNTER SERIOUS FINANCING PROBLEMS IN SHORT RUN, BUT ADDED CAVEAT THAT UNLESS CURRENT ACCOUNT DEFICIT REDUCED, BURDEN OF DEBT WOULD BECOME INSUPPORTABLE IN MEDIUM TERM.

3. FRG AND ITALIANS SAID THAT TURKS HAD PAID INSUFFICIENT ATTENTION TO ATTRACTING FOREIGN DIRECT INVESTMENT.

THEY COMMENTED THAT INFLOWS OF DIRECT INVESTMENT WOULD ALLEVIATE PROBLEM OF FINANCING CURRENT ACCOUNT DEFICIT AND WOULD OFFER FURTHER ADVANTAGES OF EMPLOYMENT-CREATION AND TRANSFER OF TECHNOLOGY. TURKS SAID THEY WERE REVIEWING THEIR ADMINISTRATIVE AND LEGAL PROCEDURES WITH EYE TOWARD REDUCING IMPEDIMENTS TO INVESTMENT INFLOWS. HOWEVER, THEY ADDED THAT PERMISSION TO INVEST WOULD BE ON A

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PROJECT-BY-PROJECT BASIS, AND THAT PERMISSION WOULD BE GRANTED ONLY IN CASES WHERE (A) SIGNIFICANT TRANSFER OF TECHNOLOGY WOULD RESULT, OR (B) INVESTORS PLANNED TO PRODUCE FOR EXPORT. FURTHERMORE, AGREEMENTS ON LICENSING AND ROYALTY ARRANGEMENTS WOULD BE FOR SPECIFIC PERIODS. TURKS GAVE IMPRESSION AT EDRC MEETING THAT CLIMATE FOR FOREIGN INVESTMENT WILL NOT IMPROVE SUBSTANTIALLY IN NEAR FUTURE.

4. TURKS EMPHASIZED THAT CURRENT ACCOUNT DEFICIT COULD REACH \$5 BILLION PER ANNUM BY 1980. THEY REMARKED THAT

EVEN IF TOTAL CAPITAL EQUIPMENT REQUIREMENTS FOR DOMESTIC MANUFACTURERS WERE OBTAINED THROUGH FOREIGN DIRECT INVESTMENT, VALUE OF INFLOWS IN 1980 WOULD BE ONLY \$1 BILLION, OR A MERE 20 PERCENT OF ESTIMATED CURRENT ACCOUNT DEFICIT IN THAT YEAR. TURKS CONCLUDED THAT DIRECT INVESTMENT COULD NOT BE IMPORTANT SOURCE OF EXTERNAL FINANCE. U.S. SUGGESTED THAT CRITERION CHOSEN BY TURKS TO MEASURE IMPORTANCE OF DIRECT INVESTMENT QUESTIONABLE, SINCE HYPOTHESIZED CURRENT ACCOUNT LIMITED OFFICIAL USE

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SCENARIO TO 1980 WOULD BE FINANCIALLY INFEASIBLE.

5. DOMESTIC OUTLOOK: SEVERAL DELS CRITICIZED TURKISH ECONOMIC PERFORMANCE IN 1975, NOTING THAT ACTUAL CONSUMPTION GROWTH WAS DOUBLE PROGRAMMED RATE, WHILE INVESTMENT INCREASE WAS JUST OVER ONE HALF OF PROGRAMMED RISE. TURKS ACKNOWLEDGED THAT 1975 FIGURES ON INVESTMENT AND CONSUMPTION SPENDING APPEARED TO SUPPORT THIS CRITICISM. THEY NOTED, HOWEVER, THAT IN TURKISH NATIONAL INCOME ACCOUNTS CONSUMPTION SPENDING IS CALCULATED AS A RESIDUAL, AFTER ALLOWING FOR CHANGES IN SUCH SLIPPERY ITEMS AS INVENTORIES. THUS, MEASUREMENT OF CONSUMPTION SUBJECT TO GREAT UNCERTAINTY. MOREOVER, THEY COMMENTED THAT HIGHER-THAN-PROGRAMMED CONSUMPTION SPENDING DID NOT DRAW RESOURCES AWAY FROM INVESTMENT, SINCE ADDITIONAL RESOURCES EQUAL TO 3 PERCENT OF 1975 GNP WERE SUCKED IN FROM ABROAD. FINALLY, TURKS LAUNCHED TORTUOUS EXPLANATION OF HOW PRICE CHANGES COULD CAUSE DIFFERENCES BETWEEN ACTUAL AND PROGRAMMED INVESTMENT. EDRC RETREATED IN CONFUSION, AND DISCUSSION OF ISSUE LAPSED.

6. SECRETARIAT FIRED OPENING SHOT IN ANNUAL DEBATE ON WHETHER GROWING LABOR SURPLUS SHOULD DICTATE SHIFT OF TURKISH GROWTH PATTERN TOWARD JOB CREATION. TURKS SIMPLY REITERATED POSITION THAT RAPID CAPITAL ACCUMULATION ESSENTIAL TO INCREASE LABOR PRODUCTIVITY AND TO ENHANCE TURKISH COMPETITIVENESS INTERNATIONALLY. SECRETARIAT LET MATTER REST.

7. ECONOMIC POLICY: TURKS DID NOT FEEL THAT EXPANSIONARY FISCAL POLICY IN 1975 HAD CONTRIBUTED TO INFLATION. HOWEVER, THEY ACCEPTED REFDON CONCLUSION THAT THERE WAS NEED TO REDUCE BUDGET DEFICIT IN FUTURE. THEY NOTED THAT PRIMARY EFFORT ON EXPENDITURE SIDE WOULD BE TO LIMIT CIVIL SERVICE (INCLUDING EMPLOYEES OF STATE ECONOMIC ENTERPRISES) SALARY INCREASES THROUGH THE CENTRALIZATION OF WAGE NEGOTIATIONS IN PUBLIC SECTOR. TURKS ALSO ESTIMATE THAT RECENTLY-INSTITUTED TAX REFORM SHOULD RESULT IN SUBSTANTIAL INCREASE IN REVENUES WITH

NO CHANGE IN TAX SYSTEM. TO SUPPLEMENT REVENUE-GENERATING EFFECTS OF TAX REFORM, TURKS PLAN TO IMPLEMENT VAT.
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EDRC FOCUSED CRITICALLY UPON GROWING OPERATING DEFICITS OF STATE ECONOMIC ENTERPRISES (SEE'S), AND PARTICULARLY

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UPON PRACTICE OF FINANCING SEE DEFICITS THROUGH CENTRAL BANK ADVANCES. TURKS DID NOT VIEW SEE DEFICITS AS PRESSING PROBLEM. FURTHERMORE, TURKS SEE NO NEED IN 1976 FOR CENTRAL BANK TO MONETIZE GOVERNMENT DEBT. ALTHOUGH THEY PROJECT INCREASE IN BUDGET DEFICIT TO TL 12 BILLION IN 1976 (FROM TL 6.7 BILLION IN 1975), TURKS CONFIDENT THAT GOVERNMENT'S FINANCING NEEDS CAN BE MET THROUGH DOMESTIC BOND ISSUES.

8. EDRC LISTENED ATTENTIVELY TO TURKISH EXPLANATIONS BUT CONCLUDED THAT (A) TURKISH DEMAND MANAGEMENT POLICIES WERE MAJOR SOURCE OF DOMESTIC INSTABILITY IN 1975. DOMESTIC INFLATION SET OFF BY POLICY EXCESSES COULD AFFECT EXCHANGE RATE, LEADING TO FURTHER FEEDBACK EFFECTS OF EXCHANGE RATE DEPRECIATION ON INFLATION; (B) SEVERAL OF PROBLEMS TURKS LIKELY TO FACE IN MEDIUM TERM COULD BE ALLEVIATED THROUGH BENEFITS DERIVED FROM INTERNATIONAL COOPERATION. SPECIFICALLY, EDRC STRESSED ROIE DIRECT FOREIGN INVESTMENT COULD PLAY IN SUPPORT OF TURKISH DEVELOPMENT OBJECTIVES, AND CALLED ON TURKS TO LIMITED OFFICIAL USE

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PROMOTE FAVORABLE INVESTMENT CLIMATE.

9. POINT RE FOREIGN INVESTMENT RAISED REF B ADDRESSED PARAS 3 AND 4.
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